THE SECRETARY OF THE TREASURY
WASHINGTON
AUG. 12 1982

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(With Secret Attachment)

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE ATTORNEY GENERAL
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

Attached is an analysis of the legal issues raised by U.S. controls on exports of oil and gas goods and technology to the Soviet Union. This analysis reflects the shared views of the appropriate senior legal officers of the State, Defense, Commerce and Treasury Departments, as well as the views of the Office of Legal Counsel of the Justice Department and incorporates portions of earlier memoranda prepared by the Departments of State, Commerce, and Treasury.

David E. Pickford
Executive Secretary

Attachment

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August 11, 1982

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Legal Considerations Presented by Soviet Pipeline Export Controls

Part One: Issues

This memorandum, dealing with basic legal issues and enforcement obstacles, is the first part of a two-part legal analysis of U.S. export controls over oil and gas goods and technology destined for the U.S.S.R. A second memorandum, currently in preparation, will review the facts of particular cases and assess U.S. enforcement strategy, discussing the administrative and judicial steps which are available to achieve U.S. objectives.

I. History of U.S.S.R. Oil and Gas Controls

The first controls directed specifically at the Soviet oil and gas industry were imposed (on foreign policy grounds) on August 1, 1978. These controls required validated licenses for the export from the United States (or the re-export from any foreign country) to the Soviet Union, of (i) U.S.-origin oil and gas exploration and production equipment; (ii) U.S.-origin exploration and production technology; and (iii) the direct foreign products of U.S.-origin oil and gas exploration and production technology, if the technology was exported on or after August 1, 1978. The 1978 controls applied to exports of U.S.-origin equipment exported from the U.S. prior to August 1, 1978, but did not apply to the products manufactured abroad if based on technology exported from the U.S. prior to that date. License applications were subject to interagency review, with significant cases referred to the NSC. Licenses were generally granted.

The invasion of Afghanistan resulted in suspension of all Soviet licenses in January 1980. Following a high level review, a decision was made to approve oil and gas equipment exports and re-exports on a case by case basis, but to deny technical data for manufacture in the U.S.S.R. of oil and gas equipment.

In response to events in Poland, new regulations were issued on December 30, 1981. These regulations took two new steps: (i) expanded the 1978 regulations beyond exploration and production to include exports and re-exports of U.S.-origin equipment and technology used in connection with transmission and refining; and (ii) extended controls to the foreign direct

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products of U.S.-origin transmission and refining technology, but only if the U.S. technology had been exported from the U.S. on or after December 30, 1981.*

The Regulations which were made effective on June 22, 1982, amended the scope of controls in two principal ways: (i) prohibited the foreign subsidiaries of U.S. firms from exporting to the U.S.S.R. oil and gas equipment and technology which were not of U.S. origin; and (ii) prohibited the export by foreign firms of direct products of U.S. technology, regardless of when the technology was exported, if (a) the technology is subject to an ongoing licensing or compensation agreement, or (b) the recipient of the technology has agreed to abide by U.S. export regulations.

Prior to the June 1982 controls, foreign subsidiaries of U.S. firms were permitted to export oil and gas equipment and technology which was not of U.S. origin. Furthermore, prior to the June action, exports of foreign-produced oil and gas equipment which was a product of U.S. technology were prohibited only if (i) the export from the U.S. of the technology from which the equipment was produced occurred after December 31, 1981, (in the case of transmission and refining equipment) or after August 1, 1978, (in the case of exploration and production equipment), or (ii) the recipient of the technology had given, at the time of export from the United States, a "written assurance" (required by the Export Administration Regulations) that the technology and the direct products of that technology would not be exported to the Soviet Union and certain other countries.

Appendix A is a chart summarizing, in chronological sequence, the imposition of the controls described above.

Two points should be noted. First, the December 30, 1981 controls do not merely cover items to be used in the Urengoy to

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*In a parallel action on December 30, 1981, processing of all license applications for exports to the U.S.S.R. was suspended, and no licenses have been issued for oil and gas, or any other equipment or technology, since the end of 1981. However, some licenses issued prior to December 30, 1981, for oil and gas exploration and production equipment may still be valid.

Uzhgorod export pipeline (hereafter the "Soviet gas pipeline"). Rather, these controls as well as the controls imposed on June 22, 1981, actually apply to all oil and gas transmission equipment or technology destined for the U.S.S.R. -- whether or not related to the Soviet gas pipeline.

Second, although the legal validity of many of the controls outlined above has never been tested in court, portions of the June 1982 regulations are particularly subject to challenge for reasons outlined below. Although the Soviet gas pipeline export controls squarely raise some of these legal vulnerabilities, the number of potential litigants and enforcement actions could be reduced by limiting the scope of the June 1982 controls solely to equipment and technology affecting the Soviet gas pipeline and not to all oil and gas equipment and technology which might be exported to the Soviet Union.

II. Legal Basis of Sanctions

The following is a general assessment of the legal strengths and weaknesses, under domestic and international law, of the spectrum of U.S. export controls outlined above and summarized in Appendix A.

A. Exports from the U.S. (August 1978 and December 1981 sanctions)

There is ample authority under the Export Administration Act (EAA) for controlling exports from the United States to the U.S.S.R. of oil and gas production, exploration, transmission, and refining goods and technology (even if they are the subject of preexisting contracts). These controls are also defensible under international law.

B. Foreign Re-exports of U.S. Origin Goods and Technology (August 1978 and December 1981 sanctions)

There is a defensible basis in the EAA for controlling the re-export, from foreign countries to the U.S.S.R., of U.S.-origin goods and technology. For at least twenty years, U.S. exporters and foreign purchasers have been on notice that the United States asserts authority to control the subsequent re-export of U.S.-origin goods and technology from one foreign country to another. Although controversial under international law, controls on foreign re-exports of U.S.-origin goods and technology are defensible on the theory that if the United States can prohibit exports of goods and technology it can also impose conditions on those exports it permits, and that these conditions may follow the goods and technology into foreign jurisdictions.

C. Foreign Products of U.S. Technology (covered prospectively by the August 1978 and December 1980 regulations; covered "retroactively" by June 1982 regulations)

There is a significant risk that a U.S. court would rule that the EAA does not support our decision in June "retroactively" to assert jurisdiction over foreign products of U.S. technology where such jurisdiction was not clearly asserted or reserved (i.e., "part of the deal") at the time the technology was exported from the United States.

Regulations prohibiting the export of foreign-produced equipment which is the product of U.S. technology are based upon broad authority in the EAA to prohibit the export of goods or technology which are "subject to the jurisdiction of the United States." While a case can be made for placing new and more restrictive controls on either the re-export from a foreign country of technology which was subject to U.S. export controls when it was initially exported, or the foreign export of products of such technology, the novel element of the June expansion is the effort to cover the products of technology over which the U.S. did not explicitly retain authority at the time the technology was initially exported from the U.S. The technology exported by GE to Alsthom-Atlantique under their licensing agreement for production of turbine rotors falls into this category.

The "retroactive" control of exports from foreign countries of foreign products based upon U.S. manufacturing technology poses difficult legal questions. Unlike controls on the re-export of U.S.-origin items, including parts and components, the Export Administration Regulations have not expressly reserved the right to subject foreign products of U.S. oil and gas technology to subsequently-imposed U.S. controls. In the case of the expanded June restrictions, regulatory control was not imposed prior to the original transfer of the technology. The United States could try to claim an "implied reservation of authority" paralleling the explicit authority asserted over re-exports and over foreign products containing U.S. components, but the legal support for such a claim under the EAA is tenuous.

A claim to U.S. jurisdiction over the products of this previously-transferred U.S. technology would, as far as can be determined, have to be predicated upon a claim to continuing U.S. jurisdiction over the previously-exported technology solely on the basis of its U.S. origin. There appears to be no support in international law for such a claim. Indeed, the American Law Institute's Restatement (Second) of the Foreign Relations Law of the United States does not recognize the U.S. origin of goods or technology alone as a source of jurisdiction under international law. In this connection, it should be noted that the Circuit Court of Appeals for the District of Columbia recently reiterated

in F.T.C. v. Compagnie de Saint-Gobain-Pont-A Mousson, 636 F.2d 1300 (D.C. Cir. 1980) that, absent a clear, contrary Congressional intent, U.S. statutes posing potential conflicts with foreign jurisdictional interests must be construed so as to ensure consistency with international law.

D. Exports by foreign subsidiaries of U.S. companies. (June 1982 sanctions)

In contrast to the attempt to control retroactively the foreign products of U.S. technology, there is clear authority under the EAA to control exports by foreign subsidiaries of U.S. companies. Under international law, a good case can be made that, in protecting important national interests, the U.S. has authority to regulate foreign firms controlled abroad by U.S. nationals (at least where there is no clear conflict with foreign law).

However, even this approach is highly controversial. The British and others claim that corporations organized under their laws are juridical persons in the jurisdiction of incorporation and cannot be subject to control by the United States merely because they are owned or controlled by U.S. nationals.

With the exception of Treasury regulations imposed in the past under the President's statutory national emergency powers, the June 1982 regulations are the first broad extension of controls over exports of completely foreign-source items by U.S.-owned or controlled firms abroad. If other nations enact or enforce blocking statutes, these controlled U.S. subsidiaries may be placed in an awkward and costly jurisdictional tug-of-war.

III. Enforcement Issues

Whatever the legal merits and vulnerabilities of the oil and gas export controls, their successful enforcement will initially turn on issues of jurisdiction and leverage over offending entities. There are two ways in which the current controls may be enforced -- administrative procedures instituted by the Commerce Department and enforcement by a U.S. licensor or the United States Government of rights under contracts. Of these, the administrative course appears to us to have a far greater chance of success.*

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*There are likely to be many obstacles to criminal prosecution of violations of our controls by non-U.S. citizens in foreign countries. Criminal prosecutions involve a heavy burden of proof, require that the defendant be brought before the court, and would likely entail more rigorous judicial review of the legal authority for our regulations.

A. Administrative remedies

The following measures are available under the EAA and the Export Administration Regulations to deal with violations or threatened violations of the oil and gas controls.

1. Bringing an administrative enforcement action against any U.S. firm, or any foreign firm subject to the controls, which sells, purchases, or uses pipeline-related goods or technology with knowledge or reason to know that a violation (i.e., sale to the U.S.S.R.) is about to or is intended to occur. Administrative sanctions include civil fines and denial of export privileges. Denial orders typically prohibit U.S. exporters and foreign consignees of U.S. goods and technology from exporting or re-exporting U.S. origin items to the firm being sanctioned, thus effectively cutting off a foreign firm's access to all U.S.-origin goods and technology.

2. Temporarily denying export privileges, on an ex parte basis, to any U.S. or foreign firm which is under investigation for possible violation of the Regulations upon a showing that such action "is required in the public interest to permit or facilitate enforcement" of the EAA or Regulations.

3. Issuing interrogatories or requests for production of documents to affected foreign firms. Provided service can be validly obtained, failure or refusal to respond can result in the imposition of a total denial of export privileges for five years or until the interrogatories and requests are answered or adequate reason is given for failure to respond.

4. Requiring U.S. firms, through mandatory reporting requirements or compulsory process, to assist in gathering necessary information about existing and proposed contracts.

5. Seizing goods or technology which have been, are being, or are intended to be exported from the United States in violation of the EAA or Regulations. Items which are seized are subject to forfeiture.

Because these measures are administrative -- carried on within the Commerce Department -- they offer the possibility of initial enforcement of the controls without judicial involvement. The Commerce Department, in addition, may take some enforcement actions without having obtained jurisdiction through formal service of process.

However, after sanctions have been imposed, a complaining party may challenge the regulations or the method of their enforcement in court. In such a case, a complainant might attack, inter alia, the adequacy of the statutory support for the regulations, their constitutionality, their validity under international law, the jurisdiction of the Commerce Department, and the fairness of the administrative procedures which resulted in sanctions. All these grounds of attack are largely untested in U.S. courts. Where there is administrative precedent, it has generally involved persons, particularly foreign persons, who would be unlikely to appeal to U.S. courts. In deciding whether to assert particular regulatory provisions in the pipeline matter, Commerce will have to take into account the heightened likelihood of legal challenge and the consequences to enforcement efforts, generally, if a challenge succeeds.

B. Foreign Governments' Resistance to U.S. Controls

Even if these legal challenges are overcome, there is still the possibility that foreign violators will be able to escape U.S. sanctions by arguing to a U.S. court that the laws of their respective countries compel them to ignore the regulations. This "foreign sovereign compulsion" defense has never been tested in the export control area, but in any event the existence of some real legal compulsion will be necessary to give it force.

Only Britain has thus far taken definitive action under its laws to prohibit compliance with the U.S. oil and gas controls. It is not entirely clear at this point to what degree France, Italy or West Germany presently have (or could quickly put into place) the domestic legal authority necessary to prohibit compliance with the controls. These three governments have, with varying degrees of firmness, expressed an official policy that their companies should proceed to perform their pipeline contracts. But, as far as we know, none has yet issued anything that purports to be a legally binding directive comparable to the measures taken by the British. Actions by these governments which fall short of legally effective compulsion of the relevant licensees or subsidiaries would substantially reduce the effectiveness of the foreign sovereign compulsion defense if asserted by any of the nationals of these three countries in the U.S. courts.

Nevertheless, the British actions on June 30 and August 2 under their Protection of Trading Interests Act appear to operate as a direct compulsion, under penalty of unlimited fines, on the four companies specified by the British Secretary of State, not to comply with U.S. oil and gas controls (although copies of the actual "directions" issued by the British Government to the individual companies have not yet been obtained by the U.S. Government). While the British action does not appear directly to compel the four British companies to respect their pipeline-related contracts, and while there is some doubt whether the

British statute would even provide authority for such direct compulsion, the steps appear at a minimum to have the effect of removing any valid excuses under UK law for non-delivery that the four companies might otherwise have derived from the expansion of the U.S. export controls.

With respect to U.S. investigations to enforce U.S. controls, French and British blocking statutes would in all probability be used to bar companies within their territories (under pain of criminal penalties) from providing documents or information to U.S. enforcement officials. Official cooperation from any of the European governments (as in the service of interrogatories or compelling the production of documents) could not be expected in enforcing U.S. controls, and U.S. investigatory activity could be seriously complicated.

C. Contractual Remedies

The second memorandum in this two-part legal analysis will address, among other matters, the specific terms of the contracts relating to the particular equipment and technology covered by export controls. While it is possible that some of these contracts may afford the U.S. contracting party a remedy if the foreign purchaser of U.S. goods or technology disregards U.S. export controls, the usefulness of such a remedy is subject to question. Where the remedy is solely that of the U.S. contracting party we will have to determine whether the U.S. person can be compelled to pursue it (or is likely to do so voluntarily) and if not, whether the U.S. Government can bring a suit as an interested third party to enforce that U.S. party's contractual remedy. In short, it is not yet clear that any remedies provided in particular contracts will provide the U.S. Government a means of enforcing current oil and gas export controls. Moreover, any available contractual remedies will be difficult to enforce as a practical matter, because such enforcement may depend on the assistance of a foreign court.

IV. Conclusion

This memorandum has attempted to identify in general terms the strengths and weaknesses of the U.S. position and the difficulties which may be faced in enforcement. The second part of this analysis will explore enforcement strategies in particular types of cases.

APPENDIX "A" SECRET

DATE OF REGULATIONS	U.S.-ORIGIN ITEMS Licensing Requirements Imposed on Exports From the U.S. and Re-exports From Outside the U.S. of U.S. Origin Items by All Firms to USSR	NON-U.S.-ORIGIN ITEMS Licensing Requirements Imposed on Exports From Outside the U.S. of Non-U.S. Origin Items by U.S. Firms or Their Foreign Subsidiaries to USSR	DIRECT FOREIGN PRODUCTS OF U.S. TECHNOLOGY Licensing Requirements Imposed on Exports From Outside the U.S. of Foreign Products of U.S. Technology by All Firms to USSR
August 1, 1978	Oil and gas exploration and production equipment and technology	No restrictions	Direct products of specified U.S. exploration and production technology exported from U.S. after August 1, 1978
December 30, 1981	Oil and gas transmission and refining equipment and technology	No restrictions	Direct products of specified U.S. transmission and refining technology exported from U.S. after December 30, 1981
June 22, 1982	No new restrictions	Oil and gas exploration, production, transmission and refining equipment and technology	Direct products of U.S. technology relating to oil and gas exploration, production, transmission and refining -- regardless of when the technology was exported -- if such technology is currently subject to a license agreement or if foreign exporter agreed to abide by U.S. export controls.